

## TAKES VS. ENTITLEMENTS

Industry asked when the list identifying the marginal properties agreements will be issued. MMS stated that we now have a target date of January 1998.

Roman Geissel mentioned that MMS is looking at modifying existing regulations such as 202 and 206 regulations as they pertain to value since we are looking at a different method to value the true up for the marginal property reporting exception. The value would be based on any sales during the year if it is an arms-length sale. Use 206 if you have a non-arms-length sale or no sales during the year.

The interest regulation will address how interest is calculated on the true-up adjustment. Reporting responsibility for Indian leases will be addressed in another regulation, 206.170.

The draft proposed rule for Section 6., Takes vs. Entitlements and the Marginal Property Exception will be sent to Cynthia Quarterman in December 1997. MMS is considering issuing a "Dear Payor" letter before the regulation is published. MMS can issue the "Dear Payor" letter because we are just explaining the law. The marginal property list will be made available through Internet access. In addition, MMS has committed to sending the various trade groups copies of the list for distribution to their membership.

Industry expressed some concern about some companies still reporting and paying on the basis of takes, even though RSFA was passed. The major problem is with pre September 1996 sales periods. Don Sant stated that MMS would like the companies to work it out amongst themselves from a balancing agreement standpoint, but that ultimately the lessee is responsible if we cannot get the taking party to pay the royalties.

Industry questioned if companies are switching from takes to entitlements, did they have to balance out the overs and unders, resolving all outstanding discrepancies? Is MMS asking people to go back to day one and switch to entitlements if they have an imbalance on production between the taking parties? Don Sant stated that the rule will not address the switch from takes to entitlements or vice versa. John Price mentioned that with anything occurring prior to September 1, 1996, there are questions to the rules. It is not MMS' desire to undo already resolved AFS/PAAS Comparison exceptions. Work it out amongst yourselves.

Don Sant mentioned that Indian properties will always be on entitlements, pre or post RSFA.

Industry asked about stand-alone leases; i.e., 100 percent takes, with respect to commingling permits as occurs with through-put agreements. Industry has meters and instructions from Eric Primeaux that they will allocate on a certain basis. How do we handle this scenario under the 100 percent takes method? Roman Geissel stated that the royalties will be due in accordance with the commingling approval letter's method of allocation.

Industry restated the issue by saying we have to keep the lease whole. If lease A is allocated 100 units but only sold 95 units because the other lease we are commingling with, lease B, got 105 units and sold 105 units, lease A's sales are not making them whole. Should the regulation clarify

that if you have a stand-alone lease but it goes through a through-put agreement, you still have to keep your lease whole? Industry and MMS agreed that it should be addressed in the regulation. (MMS agreed to add a question to the regulation such as, "How do I report and pay if I am in a commingling agreement?") Industry stated that the answer should be that if there is commingling of production prior to measurement for royalty purposes, MMS wants the lease to be kept whole. For production imbalances that occur between co-owners of leases and agreements, royalty payments will be balanced against your allocated production per the commingling agreement. MMS agreed to address this issue in the proposed regulation.

MMS stated that you could agree to pay on entitlements if all parties agree and so notify MMS in writing. MMS will not be involved in imbalance situations.

Industry asked what MMS would enforce prior to the effective date of RSFA with respect to takes and entitlements. MMS' position would be to follow the payor handbook first which recommends takes. However, we would ultimately go to the lessee, so entitlements would be the next step. We have to ensure that the property is kept whole.

Industry asked if the list of units that are identified as 100 percent federal that report on takes includes commingling units? John Price indicated that you must report on takes and there was nothing in RSFA that would allow you to pay on less than 100 percent of the allocated production to the property.

Industry recommended that everyone should just agree to pay on entitlements. Roman Geissel stated that RSFA does require the affected parties to submit a request to pay on entitlements for 100 percent federal properties. Industry stated that you have to determine where the takes are. Where do you deem that takes are? MMS suggested using the royalty meter, which is the facility measurement point. The allocation set up in the commingling approval letter is your sales. If you are the only owner and get allocated more than your allocated share, don't pay royalties on more than your allocated share. Total deliveries cannot be more than the production at your lease.

If company A is 100 percent lease owner, produced 100 barrels but was allocated sales of 110 barrels, company A should report 100 barrels. Company B, who produced 100 barrels but was allocated sales of 90 barrels under the commingling agreement, should report 100 barrels instead of 90 to make his lease whole.

Liability is set on entitlements. The underlying lessee is still liable if the taking party refuses to pay or goes belly up.

MMS stated that we will live under the "Dear Payor" letter that is targeted to be issued along with the proposed rule in February 1998, until the proposed rule goes final.